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JAPAN ECONOMIC INSTITUTE

JEI REPORT

NO. 45B
November 22, 1985

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Congressional Conference Discusses Exchange Rates

About one hundred bankers, economists, lawmakers and government officials from major industrial countries attended last week's congressional conference on exchange rates in Washington. The November 12-13 meeting, attended by Treasury Secretary James Baker and Deputy Treasury Secretary Richard Darman and co-sponsored by Rep. Jack Kemp (R, N.Y.) and Sen. Bill Bradley (D, N.J.), reflects growing congressional concern over the high value of the dollar and its effect on the U.S. economy.

preliminary budget guidelines. Usually, this is followed by intense JDA lobbying and results in slightly higher final figures from the tight-fisted Finance Ministry. Last-minute intervention by Prime Minister Yasuhiro Nakasone to raise defense allocations has also been part of the annual drama in recent years.

If previous experience is any guide, MOF will settle on a spending hike of about 6 percent, just under the 7 percent figure sought by JDA. The prime minister may again step in to boost the number by a few tenths of a percent. The new budget figure is especially significant because it is the first installment in the new five-year plan. Japanese defense budget analysts agree that annual average increases of at least 6 percent will be needed to meet the agency's goals.

The previous five-year program was heavily criticized by some American observers -- despite its status as only a planning document -- because it was considered inadequate to meet defense policy goals, such as the 1,000-mile sealane defense. Furthermore, funding was deemed insufficient to meet the majority of the acquisition goals defined in the program. (Roughly 40 percent of the program was completed when JDA began developing new targets.) Anything much less than a 7 percent increase would start the new program off on the wrong foot and could bring another outcry about Japan's "free ride."

MOF officials may hope to capitalize on recent defense policy debates in the Diet and the unusually strong public reaction to intimations that the budget may breach the one percent barrier. The ministry has been a key force in restricting defense spending in the past and remains committed to its tight budget policies. Viewed in that light, the press leak assumes a slightly different character, suggesting that MOF may indeed seek to reduce JDA's preliminary increase by almost half.

Michael W. Chinworth

Japan's Stake In The Philippines

Continued signs of political instability in the Philippines have caused growing concern among Japanese government officials. Although not yet fearful of an outright revolution, officials are aware that rising internal disputes coupled with stagnant economic performance could spill over into Southeast Asia and have a serious long-term impact on Japanese interests, ranging from regional and bilateral trade to larger security issues. Among these are:

- Impact on ASEAN - Turmoil within the Philippines could easily erode the economic and political viability of the Association of Southeast Asian Nations by weakening its internal cohesion. Like the United States, the Japanese government has looked to ASEAN to serve as both an economic stimulus for the region and as a politically stabilizing agent. A weakened ASEAN could result in reduced Southeast Asian markets for Japan. Moreover, the organization might be forced to turn to Tokyo for greater economic assistance should it find one of its members foundering.

Some observers have argued that the American military presence in the region has enabled ASEAN nations to remain uncommitted in security terms to

other powers in the area, or to remain close to the United States. A reduced U.S. military presence through the loss of U.S. bases in the Philippines, they argue, would eliminate this option for some and could necessitate closer ties with the People's Republic of China or even the Soviet Union.

• Foreign Assistance - The Philippines has ranked among the top ten recipients of Japan's foreign aid over the last five years and continues to figure prominently in aid plans. Japan has cooperated with the Philippines to a certain degree in aid projects and in other financial areas -- restructuring Philippine debts, for example -- but the Marcos government seeks more assistance. The president's wife, Imelda Marcos, recently visited Japan to urge officials to boost Japan's commitments to Manila.

Aid to the Philippines has increased from $137 million in 1982 to $160 million in 1984 (down from $210 million in 1981 but still comparable to the $180 million in direct military and economic aid from the United States). Steady and measured increases are likely, but rather than risk being identified with the old regime should a dramatic -- and possibly negative -- change in government occur, the rate increases are not likely to exceed the levels of the last three years. Furthermore, regional diversification has been a key element of recent Japanese aid strategies, and Tokyo is not expected to reverse the trend.

Japan's Aid to the Philippines, 1980-84

(in millions of dollars)

Year	Amount	Rank
1980	$94.0	6
1981	210.0	4
1982	137.0	5
1983	147.0	4
1984	160.0	5

• Investment and Trade - Japanese companies have invested $832 million in the Philippines. Although the amount is small in contrast to Japan's investments in other nations, it is perhaps this stake that is the most vulnerable. Although it is officially denied, firms in remote areas are said to be paying what amounts to protection fees to local rebels in return for relatively unrestricted operations. Rebel forces are strong in certain regions and are said to be capable of disrupting corporate operations under present conditions. A rebel-backed government, presumably, could do more, including nationalize foreign-affiliated firms.

Japan is the Philippines' largest trading partner after the United States. Two-way trade totaled $2.5 billion in 1984, with the Philippines providing primarily raw materials (iron ore, lumber, nonferrous metal scrap), while Japan exported manufactured goods. Total trade has declined steadily over the years, due to significant drops in Japanese exports to the Philippines.

Accounting for only 0.6 percent of Japan's total exports and 1 percent of its imports, the Philippines is not important in terms of overall Japanese trade, but analysts view the trade relationship as significant if only because of the Philippines' continued economic problems and its implications for ASEAN trade relations. Furthermore, given the Philippines' resource base, there is potential for sustained and perhaps expanded trade ties if political problems do not impact negatively on bilateral relations.

The Japanese government would certainly try to remain flexible in order to permit continued trade ties in the event of a change of government. While an ouster of the Marcos government might cause trade with Japan to falter, more moderate transformations might not produce any noticeable changes in trade relations.

Japan's Direct Investment in the Philippines, FY 1980-84

(in millions of dollars)

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	Total March 31, 1985
$78.0	$72.0	$34.0	$65.0	$46.0	$832.0

Japan's Trade with the Philippines, 1980-85

(in millions of dollars)

	Exports	Imports	Two-Way Trade
1980	$1,951.4	$1,683.3	$3,634.7
1981	1,731.2	1,928.3	3,658.5
1982	1,576.2	1,803.0	3,379.2
1983	1,306.5	1,743.6	3,050.1
1984	1,418.6	1,079.9	2,498.5
1984 January-September	1,103.3	775.8	1,879.1
1985 January-September	969.7	522.0	1,491.7

• Security - Critical long-term considerations for Japan in the Philippines focus on security issues. Although the loss of American bases there is still unlikely, that worst-case scenario has been considered more seriously in recent months. A U.S. withdrawal could mean a corresponding increase in Soviet naval power in the region. With a base of operations in Vietnam, the Russian navy would have greater room to maneuver in the Indian Ocean and South China Sea.

Rep. Stephen Solarz (D, N.Y.), chairman of the House Foreign Affairs Subcommittee on Asian Affairs, noted recently that Japan and other Asian nations should feel secure that "the United States will not retreat to

Honolulu" and abandon its Pacific power status. While total U.S. force levels might not be reduced in such a case, however, the actual geographic reach of American military influence in the region would decline. Furthermore, the need to construct new facilities or expand existing ones could mean a serious shift of U.S. resources in the region, leading one specialist to suggest that for a few critical years, the ability of the United States to maintain an effective presence in northeast Asia would be reduced.

It is highly possible that Tokyo would face pressures to accelerate its defense spending, particularly in the realm of defending the sealanes approaching Japan, should the United States be forced to withdraw from or reduce its presence in the Philippines. Yet it is politically and economically unlikely that the country would be in any position to accelerate its defense spending sufficiently to meet that contingency.

Although the Marcos government remains far from the point of collapse, the situation is serious enough to cause concern. Japanese officials, however, are hesitant to assume a high profile in the country for fear of a negative reaction and accusations that it is trying to influence internal affairs.

Michael W. Chinworth

U.S. Policy Could Plunge Global Shipping Into Hot Water

The Reagan administration continues to roil the waters of the global shipping industry by insisting on free-market mechanisms when subsidization and regulation are the norms. The situation is exacerbated by a global oversupply of shipping and shipbuilding capacity that has spurred other nations to even greater interference in the marketplace. Armed with legislation granting retaliatory powers, the administration is threatening to step up its free-trade efforts and upset the carefully laid plans of foreign shippers.

The strategic nature of sea transport and shipbuilding capability has long been recognized. The use of building and operating subsidies and domestic flag laws arose in developing and industrialized countries for opposite reasons. Developing nations employed such schemes to create and to protect infant shipping firms from harsh international competition. Industrialized nations, on the other hand, also adopted these practices to fend off the challenge of low-wage nations and preserve a minimum of shipping capacity for national security reasons. The two sides appeared to have hammered out a compromise in 1982 when the United Nations submitted a new Law of the Sea treaty that permits nations to reserve specific percentages of commercial cargo for national merchant fleets above and beyond existing government requirements. Japan and Europe signed the treaty in 1982, but the United States remains adamantly opposed to any reservation schemes for liner service.

Since 1982, the Consultative Shipping Group has served as a forum for the United States, Japan and Europe to work out their differences on a new international liner code. With negotiations making little progress, Congress passed the Shipping Act of 1984 hoping to strengthen the administration's bargaining hand. Section 13(B)(5) of the act gives the Federal Maritime Commission the power to retaliate against restrictive foreign shipping practices. With this sword in hand, the administration took an even harder line against cargo reservation systems by insisting on November 13 that U.S.